No. 13110.

IN THE

United States Court of Appeals

FOR THE NINTH [?] CIRCUIT

John Lucas Hudson [?], Sr. and Pacific-Palisades [?] Development Company, a corporation,

Appellants,

vs.

[illegible] A. [illegible], as Trustee in Bankruptcy of the Estate of John Lucas Hudson [?], Sr., a Bankrupt,

Appellee.

APPELLANTS' OPENING BRIEF.

[illegible] C. [illegible],
[illegible] Wilshire Boulevard,
Santa Monica, California,
Attorney for Appellants.

Parker & Son [?], Inc., Law Printers, Los Angeles. Phone MA. 6-9171 [?].

TOPICAL INDEX

TABLE OF AUTHORITIES CITED

STATUTES

TEXTBOOKS

No. 15110.

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

JOHN LUCAS HUDSON, SR., and PACIFIC-PALMDALE DEVELOPMENT COMPANY, a corporation,

Appellants,

vs.

WILLIAM A. WYLIE, as Trustee in Bankruptcy of the Estate of JOHN LUCAS HUDSON, SR., a Bankrupt,

Appellee.

APPELLANTS' OPENING BRIEF.

Statement of Jurisdiction.

This is an appeal from an order of the District Court, outhern District of California, Central Division, af- rming on review, Findings of Fact, Conclusions of Law nd Order of a Referee in Bankruptcy. Jurisdiction f the District Court existed under Section 67(c), Title , U. S. C. A. Jurisdiction of this Circuit Court of ppeals lies under Section 47(a) and (b) of Title 11, . S. C. A.

Statement of the Case.

This appeal is taken from an order of the District Court in a summary proceedings in favor of William A. Wylie, trustee in bankruptcy of the estate of John Lucas Hudson, Sr., confirming a decision by the Referee holding that the trustee was entitled to certain sums and credits arising on account of personal services of the bankrupt rendered before and after adjudication under a contract alleged by the trustee to have existed prior to adjudication.

In 1952 the bankrupt made an assignment for the benefit of his creditors [R. p. 205]. An attorney, Mr. Granger, had represented the bankrupt in a lawsuit prior to his assignment, but did not represent him therein nor again until early in 1954 [R. pp. 232-233]. Attorney Granger, desiring to exploit the bankrupt's talents for mass production in construction, obtained his oral statement that his personal services would be available to Mr. Granger in any deal he might later set up [R. p. 233]. Prior to March, 1954, Mr. Granger, in the name of Sierra Construction Company, submitted to Commodity Credit Corporation (hereinafter referred to as CCC) a request for the right to bid on a contract for the fabrication and erection of grain bins. The request was not answered for several months. While the bankrupt was employed for wages as a construction foreman in San Diego Mr. Granger conceived the idea of a program for the mass production of homes, and developing the idea investigated the various areas where an active demand for homes would encourage FHA and VA government loans and determined upon Palmdale, California, as a likely area [R. p. 235]. About January, 1954, Mr

Granger, in company with the bankrupt, one Philip Bloom, and another unidentified man, visited Palmdale and located a piece of property suitable for immediate subdivision belonging to one Thornburg [R. pp. 273-275]. Mr. Bloom was a building contractor with offices in Culver City, California. In March, 1954, Mr. Bloom, Mr. Granger and Blanche V. Hudson, wife of the bankrupt, signed and acknowledged Articles of Incorporation of Appellant corporation, Pacific-Palmdale Development Company (hereinafter referred to as PPD Co). The articles had not yet been filed with the Secretary of State when Mr. Granger received from CCC an invitation to bid for a contract to construct grain bins. Mr. Granger at once conferred with the bankrupt and while the latter was in the office of Liff & Kim, architects, in reference to the housing deal at Palmdale, Mr. Hudson learned of one Lloyd R. Reeve as a prospect to finance the grain bin deal. This was about April 3, 1954 [R. pp. 71, 72]. There followed negotiations which speedily resulted in the preparation of a joint venture agreement whereby the Reeve interests would finance and manage the grain bin deal and PPD Co. would make available to Reeve interests the personal services of the bankrupt for one-half the profit [Tr. Ex. 1]. The agreement was prepared by Mr. Granger representing PPD Co. and Mr. Hinton, as attorney for the Reeve interests, on April , 1954 [R. p. 166]. The agreement was finished late the day and at once flown by Mr. Reeve to Washington, D. C. [R. pp. 328-329] where the bankrupt was awaiting him. Articles of PPD Co. were filed in Sacramento on the day of the night Mr. Reeve flew to Washington and a certified copy was not yet available to the directors in Santa Monica and Culver City, hence

at the time Mr. Reeve left for Washington, there was no authority set up to sign the agreement nor was it signed by any agent of PPD Co. [R. pp. 328-329]. Mr. Hudson telephoned Mr. Granger and stated that Mr. Reeve desired the agreement executed before a bid was submitted to CCC [R. pp. 331-332]. When there appeared the necessity for executing the agreement at once at Washington, D. C., Mr. Granger commissioned the bankrupt to sign it for PPD Co., with his agency then to end [R. pp. 328-329]. As soon as was reasonably possible this action was approved and adopted into PPD Co. corporate records as shown by Respondents' Exhibit G [R. p. 247].

About April 9, 1954, the bid was filed with CCC following 3 days work at Washington, D. C., by Mr. Reeve and the bankrupt [R. pp. 91-92]. On April 17, 1954, CCC conditionally accepted the bid [R. p. 93]. On April 19, 1954 (date of filing of the petition in bankruptcy herein and adjudication) Reeve, Inc., accepted the conditions of the earlier CCC acceptance, but then had yet to put up a performance bond which was not posted until after April 28, 1954 [R. p. 225]. On April 20, 1954, PPD Co. adopted a resolution to employ the bankrupt on the grain bin deal for a compensation of the first $50,000.00 of its profit and 50% of all other profit after PPD Co. had received a similar amount [R. p. 250 and Resp. Ex. D]. The bankrupt accepted a written memorandum of the terms of the employment on May 3, 1954, after returning from Sacramento to aid Mr.

Reeve in posting the bond. The joint venture earned a profit of which $20,000.00 was paid to PPD Co. and by it to the bankrupt. More is yet to be paid at the close of litigation between the joint venturers.

The District Court held PPD Co. to be the *alter ego* of the bankrupt and a means to defraud the estate of profits from the grain bin deal. It held the bankrupt indebted unto his estate for all profit he received from the grain bin deal and substituted the trustee in place of PPD Co. in a state court action against the Reeve interests for an accounting. The bankrupt and PPD Co. prosecute this appeal.

Specifications of Error.

The Court erred in each of the following respects:

1. Finding of Fact VII [R. pp. 18-20] is not supported by the evidence.

2. Finding of Fact XXIV [R. pp. 24-25] is not supported by and is contrary to the evidence.

3. Finding of Fact XXV [R. pp. 25-26] is contrary to and not supported by the evidence.

4. Finding of Fact XLV [R. p. 31] is contrary to and not supported by the evidence.

5. Finding of Fact XLVI [R. p. 32] is contrary to and not supported by the evidence.

6. Finding of Fact XLVII [R. p. 32] is not supported by the evidence.

7. Finding of Fact XLVIII [R. pp. 32-33] is not supported by and is contrary to the evidence.

8. The Findings of Fact fail to find on any of the facts established by the evidence, which are as follows:

(a) When he filed his Petition in Bankruptcy the bankrupt and his wife and children resided together in California.

(b) The bankrupt's wife never joined in nor consented to any assignment by him of his future earnings.

(c) All sums paid to the bankrupt or to PPD Co. under the joint venture agreement were paid only in consideration of the personal services performed by the bankrupt.

(d) The fund from which any sums were paid, in the grain bin deal, unto appellants did not come into existence until after April 19, 1954.

(e) Services of the bankrupt on the grain bin deal and compensation for same were not reasonably divisible into those proportions of the whole performed or earned before and after April 19, 1954.

(f) The services performed by the bankrupt on the grain bin deal were performed both before and after April 19, 1954, a substantial portion of the whole being required to be performed after April 19, 1954, in order to earn any compensation under the joint venture agreement and employment contract.

9. Each of the Conclusions of Law except V and XII are against the law and the evidence.

10. The Court erred in approving and affirming the Referee's decision of December 6, 1955.

Summary of Argument.

Appellants believe their argument sustains all the foregoing specifications of error and tends generally to establish the following conclusions as determinative of the appeal.

1. The Appellate Court is not bound by the trial Court's Findings of Fact.

2. Employment of the bankrupt and the fund from which his services were to be paid did not exist actually or potentially on April 19, 1954.

3. Wages may not be assigned when they are to be earned under a contract which is merely possible at the time of the assignment.

4. No inquiry can be made into the question of corporate *alter ego* if no fraud or inequitable position is being shielded thereby.

5. There can be no actionable fraud without damage and creditors cannot be defrauded of that to which they are not entitled.

6. Earnings of the bankrupt in the grain bin deal were subject to his contract as his property and did not belong to his trustee in bankruptcy.

7. PPD Co. was not the corporate *alter ego* of the bankrupt.

8. Assuming PPD Co. to be the corporate *alter ego* of the bankrupt, yet the trustee and creditors are not entitled to the bankrupt's earnings and no fraud was intended or committed or inequitable position created.

ARGUMENT.

I.

The Appellate Court Is Not Bound by the Trial Court's Findings of Fact.

A. When there is no conflict in the evidence on material issues, an appellate tribunal is in as good position as the trial court to draw inferences from the evidence and is not bound by the trial court's findings.

See:

In re Jersey Materials Co., 50 Fed. Supp. 428, 53 Am. Bk. Rep. N. S. 359;

In re Hedgeside Distillery, 123 Fed. Supp. 933 942 (I);

Stewart v. Ganey, 116 F. 2d 1010, 1013;

Sheldon v. Waters, 168 F. 2d 483.

There is no conflict in the evidence which established these determinative facts:

1. PPD Co. articles of incorporation were signed March 9, 1954 [Resp. Ex. I].

2. Said articles of incorporation were forwarded to Sacramento by Mr. Granger on April 3, 1954, and filed with the Secretary of State on April 6 [R. p. 239].

3. When said articles were signed and acknowledged the original invitation from CCC to bid on the grain bin deal had not been received [R. pp. 234-235].

4. Negotiations with Mr. Reeve for financing the grain bin deal did not start until April 2 or 3, 1954 [R. p. 71].

5. The joint venture agreement between PPD Co. and Reeve was formulated April 6, 1954, and executed April 7, 1954 [R. p. 78].

6. Philip Bloom had no interest in the grain bin deal at any time [R. p. 290], but his interest in and activity with PPD Co. continued many months until as late as April 25, 1954 [R. pp. 294, 297 and Resp. Ex. J].

7. The night of the very day said articles were filed at Sacramento, Mr. Reeve flew the unexecuted joint venture agreement back to Washington, D. C., and desired that it be executed before any bid was submitted to CCC. Thereupon, by telephone call, Mr. Granger authorized the bankrupt to sign the agreement for PPD Co., limiting his authority to that act and the return of the contract to PPD Co. [Resp. Ex. G, R. pp. 328-329].

8. PPD Co. as a party was discussed prior to drafting the joint venture agreement [R. 76]. In early April Mr. Bloom was interested in getting into the grain bin deal [R. pp. 290, 291].

9. Mr. Granger's only legal opinion to the bankrupt regarding his financial affairs was to tell the bankrupt that if he planned to save from substantial earnings the funds with which to re-establish himself in business, he should know that such savings were subject to the demands of his creditors unless they released him or he obtained a discharge in bankruptcy [R. p. 267].

10. Mr. Granger had represented Mr. Hudson in two law suits [R. pp. 232-233] and did not represent him in the assignment for creditors.

11. Mr. Granger initiated and developed the grain bin deal and the Palmdale construction deal on his own

initiative for the purpose of capitalizing on the bankrupt's talent for mass construction production [R. pp. 233-237].

12. The bankrupt performed 4 days work at Washington, D. C., prior to his bankruptcy adjudication on April 19, 1954, in procuring a CCC contract for the joint venture [R. pp. 104-105].

13. The bankrupt performed substantial service in performance of the CCC contract for bins and such service continued for more than one year following the filing of his bankruptcy petition and adjudication. Such work was necessary to the creation of the fund from which the joint venture was to derive its profit [Tr. Ex. 1; R. p. 94].

14. Neither the joint venture agreement nor the employment agreement between PPD Co. and the bankrupt divides either the bankrupt's services or compensation for his services into proportions of the whole which were performed or earned before and after his adjudication.

15. The employment agreement between PPD Co. and the bankrupt was made after his adjudication [Resp. Ex. D].

16. At the time of his adjudication, the bankrupt lived in California with his wife and children [R. pp. 196, 203].

17. The bankrupt's wife never consented to any assignment of his earnings [R. p. 206].

18. Though the Reeve bid for a grain bin contract was accepted on April 19, 1954 (date of adjudication), Reeve did not deposit his performance bond with CCC until after April 28, 1954 [R. pp. 5, 6, 107, 225].

B. Current Findings of Fact by the Referee and District Judge will not be accepted on appeal when a mistake has been clearly shown.

See:

In re Ernst, 107 F. 2d 760;
In re Hoffman, 82 F. 2d 58, 60;
Kauffman & Brown etc. v. Long, 182 F. 2d 594 (9th Cir.).

When such a mistake is shown, the appellate court's review may be as extensive as that of the District Judge.

See:

Morris Plan etc. v. Henderson, 131 F. 2d 975.

As will be shown later in this argument, the learned Referee gave no recognition whatever to rules of law which should be controlling and mistakenly emphasized an issue as paramount which would have been no issue at all had such rules of law been acknowledged.

II.

Employment of the Bankrupt and the Fund From Which His Services Were To Be Paid Did Not Exist Actually or Potentially on April 19, 1954.

A. Employment of the bankrupt, though contemplated, did not actually exist until at least April 20, 1954, when PPD Co. adopted its resolution employing the bankrupt, though he did not accept formally until May 3, 1954, when he returned to Los Angeles from Sacramento, because of Reeve's difficulty in obtaining a performance bond [Resp. Ex. D].

B. The joint venture agreement [Tr. Ex. 1] was executed April 7, 1954 [R. p. 78]. By its very terms it was

limited to the 1954 bin program of CCC and had Mr. Reeve not been awarded a CCC contract the joint venture agreement would have had no subject matter upon which to operate. Hence, until the CCC contract was awarded Mr. Reeve for 1954 the condition upon which he could utilize the bankrupt's services could not arise, except to prepare and submit a bid, and under such circumstances there was no possibility of such services ever being compensated. It appears that the terms of such agreement were determined on April 19, 1954, between CCC and Mr. Reeve by the latter's telegram accepting CCC's earlier conditional acceptance of the original Reeve bid [R. p. 15]. However, Mr. Reeve had yet to deposit a performance bond with CCC. It was not deposited until after April 28, 1954 [R. p. 225]. The simple result of this was that no contract existed between CCC and Reeve until the bond was deposited.

See:

Restatement of Law of Contracts, p. 45, Sec. 38(a), and p. 66, Sec. 60; also

Flynn v. Dougherty, 3 Cal. Unrep. 412, 26 Pac. 831, 832.

The deposit of a performance bond, though subsequent in form, is precedent in effect and no contract existed between CCC and Reeve until it was deposited.

See:

Williston on Contracts, Rev. Ed., Vol. 3, p. 1917, Sec. 667-A.

If on the date the bankrupt filed his petition and was adjudicated, there was only the possibility that he might engage in future work, certainly those services would have to be performed and their compensation earned after adjudication and the earnings would belong to the bankrupt. Under such circumstances the bankrupt's position is similar to that of a man who is hired by the month and files for bankruptcy and is adjudicated in mid-month. The law gives such a man his salary earned after the filing and adjudication, as will be seen under Point VI of this argument.

III.

Wages May Not Be Assigned When They Are To Be Earned Under a Contract Which Is Merely Possible at the Time of the Assignment.

The Reeve contract with CCC did not exist on April 19, 1954, and on that day was a mere possibility because Reeve's performance bond was not filed until after April 28, 1954. The mere possibility of wages is not subject to assignment and the filing of the petition in bankruptcy could not imply assignment of earnings under a merely possible contract, such wages not even having a potentiality until 10 days after the filing.

See:

Walker v. Rich, 79 Cal. App. 139, 249 Pac. 56.

IV.

No Inquiry Can Be Made Into the Question of Corporate Alter Ego if No Fraud or Inequitable Position Is Being Shielded Thereby.

The learned Referee was under the impression that the question of whether PPD Co. was the corporate *alter ego* of the bankrupt was the paramount issue in the case and expressly declared this opinion [R. p. 90]. From the premise of that opinion, the Referee advanced to the conclusion that if it were his *alter ego,* "it is one and indivisible, it does not make any difference whether he did or did not perform or devote himself to the joint enterprise." Such reasoning appears entirely fallacious and gives no recognition whatever to the rule that the propriety of a corporate *alter ego* cannot be questioned except to avoid a fraud or inequitable advantage which arises from the double relationship. It is common and essentially honest practice for a man to channel his personal efforts through the medium of a corporation. It is not sound to argue that a man using a corporate *alter ego* is, *ergo,* guilty of fraud because it is not enough to show that the corporation is the mere instrumentality of the individual.

See:

12 Cal. Jur. 2d, p. 604, Art. 8, and cases cited.

It must appear that to recognize separate entities would aid the consummation of a wrong.

See:

Minifie v. Rowley, 187 Cal. 481, approved in *Wenban v. Hewlett,* 193 Cal. 675, 697;

Jackson v. American Bearing, 89 Cal. App. 2d 256, 200 P. 2d 836;

Marr v. Postal Union Life Ins. Co., 40 Cal. App. 2d 673, 105 P. 2d 649.

It was necessary to determine that a fraud or inequitable advantage was created and being protected by the corporate structure before inquiry could be made into the question of the propriety of the corporate *alter ego.* This the learned Referee did not do. He regarded that question as of first importance and held that its creation was fraudulent, a finding wholly without support in the evidence as will be seen under Point VII of this argument. The Referee should have first determined whether a fraud had been committed and then made inquiry into the question of corporate *alter ego* after fraud was discovered.

See:

Chiarello v. Axelson, 25 Cal. App. 2d 157, 70 P. 2d 731;

Stanford Hotel Co. v. Scwind, 180 Cal. 348, 181 Pac. 780;

Erkenbrecker v. Grant, 187 Cal. 7, 200 Pac. 641;

Walter Co. v. Zuckerman, 214 Cal. 418, 6 P. 2d 251.

For the moment, let us reason, in part, as the Referee has reasoned, and hold that PPD Co. was the *alter ego*

of the bankrupt. This would first result in a determination that the joint venture agreement was really between Mr. Reeve and the bankrupt with the effect that, at the time of his adjudication, the bankrupt had an employment contract with Mr. Reeve under which he had done 4 days work in procurement of a CCC contract. Such CCC contract was but a potential because Mr. Reeve had yet to deposit his performance bond which he did more than 10 days after the adjudication. By the posting of the bond, and not until then, did there come into existence a subject matter for the parties to work on under their joint venture agreement, and from which pay for the services might come. As will be seen under Point VI of this argument, such pay for the services was the property of the bankrupt and not that of his estate or trustee. There is no fraud to date. Now assume that the bankrupt sees fit to divide his earnings with his wife, his son and his attorney. Still no fraud is committed, nor intended. If he seeks to effect that division through the medium of a corporation, there is still no fraud. The learned Referee reaches the fraud only by mistakenly giving prime importance to the question of corporate *alter ego* as the Referee himself declares. The close relationship between the bankrupt and PPD Co. the Referee deemed of a fraudulent character and because of it ruled that all earnings of the bankrupt for more than one year after his adjudication were the property of his bankrupt estate. An appellate court has somewhat aptly characterized a decision of such nature

as subjecting the bankrupt to an "involuntary servitude" for his creditors. The Referee, once sparked on the question of fraud, found fraud throughout transactions where there was no suggestion of fraud.

The bankruptcy act is a benevolent statute. It contemplates that an honest debtor may, under its influence, rehabilitate himself financially. It is impossible for such debtor to file under the act without in some measure contemplating his own rehabilitation and in some detail planning for personal and profitable activity after his adjudication. If such planning ripens into an asset prior to his filing, that asset belongs to his creditors, unless exempt, but if the planning and even some effort does not become an asset, neither the creditors, the trustee nor the Referee should seek to accelerate a mere potential into an assumed reality and thus prevent the rehabilitation the Act would afford. Surely a beneficent statute does not lose its beneficence merely because one planning his enjoyment of it finds that his plans have not borne fruit at the time he claims its benefits. It would seem that a bankrupt's plans for the future belong but to him, so long as he surrenders his existing assets to his creditors.

When the learned Referee emphasized the question of corporate *alter ego* as of first importance in the case he was under a mistaken concept of the law, and this is one reason why, as contended under I-B of this argument, the Appellate Court is not bound by the Findings of Fact.

V.

There Can Be No Actionable Fraud Without Damage and Creditors Cannot Be Defrauded of That to Which They Are Not Entitled.

As will appear later in this argument, the earnings of the bankrupt under the grain bin deal belonged to him. In that they were his property they could not constitute a part of his bankrupt estate. To exclude from such estate that to which the creditors are not entitled is not a wrong to the estate or to the creditors. While the bankrupt intended no fraud upon his creditors, even had he intended such by an association with PPD Co., yet the creditors sustain no damage in being deprived of that to which they are not entitled. To be actionable, a fraud must be accompanied with damage.

See:

Gonsalves v. Hodgson, 38 Cal. 2d 91, 237 P. 2d 656;

Gerini v. Pac. Employ. Ins. Co., 27 Cal. App. 2d 52, 55(3), 80 P. 2d 499;

Tsang v. Kan, 78 Cal. App. 2d 275, 177 P. 2d 630;

United States v. North Pac. Ry. Co., 188 F. 2d 277;

Ward v. Deavers, 203 F. 2d 72;

Dabney v. Levy, 191 F. 2d 201.

There being no damage or actionable fraud, the question of corporate *alter ego* was wholly immaterial.

VI.

The Earnings of the Bankrupt in the Grain Bin Deal Were Subject to His Contract as His Property and Did Not Belong to His Trustee in Bankruptcy.

A. As seen under Point III of this argument, at the time of his adjudication the bankrupt's prospect of activity under the joint venture agreement was but a possibility, until there existed a contract between CCC and Reeve and the performance bond had been deposited. Also, PPD Co. had no reason yet for defining its agreement with the bankrupt and did not do so until its offer of the next day which the bankrupt accepted on May 3, 1954. Future earnings under a contract which is non-existent are non-assignable.

See:

Orkow v. Orkow, 133 Cal. App. 50;
Cox v. Hughes, 10 Cal. App. 553;
Williston on Contracts, Vol. 2, pp. 1183-1184.

B. On April 19, 1954, the bankrupt was a married man residing with his wife in the State of California [R. pp. 196, 203]. His wife did not consent in writing to any assignment of his future earnings [R. p. 206].

Section 300 of the California Labor Code provides that the assignment of future wages of a married man is not valid unless consented to in writing by his wife. This section of the Labor Code receives a very liberal interpretation by the Courts and the terms "wages," "fees," "salary" and "compensation" are synonymous.

In *Reynolds v. Reynolds,* 14 Cal. App. 2d 481, 58 P. 2d 660, the Court said:

> "Be that as it may, a fee is compensation and compensation is salary."

Quoting from *Kirkwood v. Soto,* 87 Cal. 394, the Court further said:

> "The words 'compensation' and 'salary' were evidently used synonymously in the Constitution and the County Government Act. . . . 'Wages' and 'salary' as here employed are comprehensive terms and must be interpreted in their broader sense to mean compensation for services, whether such compensation is limited to a fixed sum of money or is payable in fees."

In *United States v. Gerdel,* 103 Fed. Supp. 635, 638, it is stated:

> "California decisions hold that the modern statutory usage of the word 'salary' is intended to embrace all forms of compensation."

C. This point in the argument impresses appellants as involving the most determinative of the various phases of this case. Let us state the rule of law for which appellants contend: If, under an existing and continuing contract, a bankrupt performs a service prior to his filing a petition in bankruptcy, and also under that contract must and does perform substantial service after such filing and his adjudication in order to make any compensation whatever payable, and the services and their compensation are not reasonably divisible into the proportions of the whole of either which were performed or earned before and after the filing and adjudication, the

entire of such compensation belongs to the bankrupt and none to his trustee.

This very Circuit Court (Ninth Circuit) has approved and adopted the rule in *Miller v. Wooley,* 141 F. 2d 837, 839, by citing and following the rule which was so clearly announced at some length in the case *In re Leibowitt,* 93 F. 2d 333, 115 A. L. R. 623, from the Third Circuit and in which the United States Supreme Court denied a writ of certiorari. In the cited case the bankrupt was an insurance agent who had a continuing contract with the insurance company. Prior to his adjudication he had written policies and had yet to perform substantial services on those policies before a salary and commissions accruing after adjudication became payable. Reference was made by the Court to Bankruptcy Act 47(a) and 70(a-5), as amended, and 11 U. S. C. A. 75, 110, and it held that the bankrupt was entitled to sums earned prior to adjudication in that they were not severable from earnings for services after adjudication.

In re Sciffert, 18 F. 2d 444, involved circumstances which are in many respects similar to those in the case at bar. The contract was a continuing one, existing long before bankruptcy, under which some work had been done before bankruptcy and more work yet to be done after adjudication in order to create the fund from which any compensation was to become payable (if the bankrupt did not elect to take a monthly salary of $40.00 as he had the right to do—an option which did not exist in the case at bar). On November 1, 1923, the bankrupt had made an agreement to manage a farm for two years and at his option could receive $40.00 per month or ⅔ of the grain and seed crops produced,

his option to be exercised not later than 10 days after threshing time. He filed his bankruptcy petition on April 10, 1924, and was adjudicated 2 days later. He did not schedule the contract. In the fall of 1924, 5,500 bushels of wheat were harvested and he elected to take his percentage of the grain. It was held that the contract had not been performed at the time of filing the petition and adjudication and no recovery could have been made upon it and charges against the bankrupt were not sustained.

The rule was recognized in the 7th Circuit in the case of *In re Thomas,* 204 F. 2d 788. The bankrupt was adjudicated July 31, 1936. It was claimed that he concealed fees earned as a State court trustee but not yet paid when he filed his petition. On August 18, 1939, he was allowed $3,500.00 fee by the State court. This fee covered almost one year prior to adjudication and three years subsequent thereto. The Referee found that portion of the fee earned prior to bankruptcy passed to the trustee. The appellate court held that as there was no way to determine what was due when the petition was filed, the Referee's division was speculative and uncertain and therefore erroneous.

The rule was announced from the 2nd Circuit in *Lockhart v. Mittleman,* 123 F. 2d 703. The bankrupt filed his petition September 1, 1939, and was at once adjudicated. Since 1935 he had acted as a State court trustee. The trustees usually filed their account every six months and the bankrupt had always been granted an allowance of $8,000.00 on an account for such period. The allowance for the term ending June 30, 1938, had been made and paid prior to September 1, 1939. On May 4, 1939, several months before the filing of the

bankruptcy petition, the trustees filed their account for the period ending December 31, 1938, but no allowance was made thereon until September 5, 1939, 4 days after the filing of the bankruptcy petition. The Referee held the sum transferable and that it should have been scheduled but on appeal the court said: "The dividing line is whether the compensation has been so far 'earned' that the officer's (bankrupt's) conduct thereafter is not a factor in determining the amount." It was held that the asset was not required to be scheduled. In the case at bar, Mr. Hudson's services after his adjudication were required to earn and produce the fund from which he was to be paid and were also necessary to determine the amount of his pay.

In re Coleman, 87 F. 2d 753, involved the bankruptcy of an attorney. He had been engaged under a contingency fee arrangement to prosecute a suit for damages which he filed before filing his petition in bankruptcy. It was held that his fees did not pass to the bankruptcy trustee as the bankrupt had no rights until his services were performed and a fund existed. In the case at bar, Mr. Hudson could receive no pay for "procurement" of the CCC contract (his services rendered prior to his bankruptcy and adjudication) because under the CCC contract no money would be owing until "performance." He was adjudicated April 19, 1954, the performance bond with CCC was not deposited until after April 28, 1954, and all "performance" was after his adjudication. The joint venture had no rights until after performance and no fund for compensation existed until after such performance.

In *Mersfelder v. Peters Cartridge,* 130 Ohio C. C. N. S. 220, it was held that an incomplete contract for

personal services afforded no asset for the bankruptcy estate of the person who was to perform them.

The foregoing citations declare for the principle that an honest bankrupt shall not be required to labor throughout the future in a sort of involuntary servitude for his creditors, yet that is exactly what the District Court decision would require of Mr. Hudson.

Counsel for the trustee are learned in the law and skilled in the procedure of the bankruptcy practice in which they have, for over 25 years, specialized with a probably more intensive activity than any law firm in California. In preparation of the petition which initiated this proceeding [R. pp. 3-9] they must have had a ready familiarity with the rule of law above set forth. They also knew the facts, including the year of service which the bankrupt gave to performance of the contract AFTER his adjudication. As astute lawyers, they knew, too, the difficulty to be experienced in recovering under the petition they were to prepare. Therefore, they declared expressly upon an ORAL contract between Reeve and the bankrupt involving merely PROCUREMENT of a CCC contract [R. p. 3, par. II], though, not to weaken their case, they also declared upon the written agreement [R. p. 4, par. V, and Tr. Ex. 1]. They declared upon "procurement" separately because they knew that all effort at procurement had been completed prior to adjudication.

The evidence failed wholly to establish the oral contract. The trustee's only witness on the matter, Mr. Reeve, testified that it was not intended to operate under an oral joint venture agreement and that it was intended that their activities were to be covered by a written contract [R. pp. 141-142; Tr. Ex. 1].

Under the rule set out in Section 1625, Civil Code of California, all oral preliminary negotiations are deemed merged into the later writing. Trustee's counsel eventually abandoned the theory of trying to establish a separate oral contract of the bankrupt to cover only the "procurement" nature of his service [R. pp. 124-127].

The rule of law first set out in this division of appellants' argument is the premise for much of their defense in this action because the joint venture agreement and the bankrupt's employment contract were continuing contracts, his services, personally performed, were their subject matter and necessary to the creation of a fund which did not then exist but from which payment for services must be made, the fund coming into existence and the large part of the services being performed after his adjudication. Such documents did not contemplate any determinable division of the services or their compensation into any proportions of the whole of each which were to be performed or earned before and after the adjudication date.

The trustee's learned counsel gave clear evidence of agreeing with appellants upon this rule of law for which they contend and, more importantly, its application to the facts of this case. Firstly: the trustee sought to have witness Reeve divide the bankrupt's services in "procurement" and "performance" into their percentages of the entire service [R. pp. 84-90]. Trustee's counsel knew how important and vital it was to his case to make this division when he said: "It is highly relevant to the determination by the Court as to what percentage was procurement" [R. p. 85]. Then again, on the page of the record last above cited, trustee's counsel further stated: "At least, that portion of the contract that was fully

performed and the amount due for procurement of the contracts was an asset of this estate." Secondly: on the same page of the record, the application of the rule to this case is admitted by the trustee when his counsel states: "As to performance after this contract, this estate has no interest."

It is unmistakable that the trustee, at this point of the record has declared his position to be that "procurement" was a service rendered prior to bankruptcy and that all compensation for such procurement belonged to the estate, and that the estate was *not entitled to any more* (italics by appellants). Also, at this point in the record it is unmistakable that the trustee claims the compensation for the services were divisible and that a portion of the whole could be assigned by the Referee to the service of mere "procurement." It is as equally unmistakable that the appellants were contending that a division of the whole compensation could not be made. The differences between the parties at this stage of the record could be summed up as follows: The trustee contends for divisibility of service and compensation, *rejecting* all of each which might be allocated to the period *after* adjudication, and the appellants contending no suggested division could be made.

It is interesting to note that the Referee's decision rejected the claims of both sides and held that *all* compensation for *all* service, without any division and without recognition of time of performance, belonged to the trustee. In reaching his conclusion, the learned Referee labored under a mistaken concept of the law which appellants have heretofore assigned as another reason why this Circuit Court is not bound by the findings of fact.

The trial record is notably wanting in any authorities cited by either party in support of their contentions on this issue. At the close of the case, when trustee's counsel arose to deliver the opening argument which would normally include and be followed by the authorities upon which the parties relied, the Referee waived aside the argument and proceeded with his statement of his decision. Had such authorities been acceptable, they might have served to acquaint the learned Referee with the rule of law which the parties acknowledged, but which, as will appear from the following excerpts of the record, was not clear in the thought of the learned Referee.

At a time when the parties' counsel were contending over the question of percentages of the service, the Referee stated: "the paramount issue here is whether or not in fact this corporation Palmdale Pacific Development Company, was not in fact the *alter ego* of the bankrupt. In other words, if the corporation was his *alter ego* and it is one and indivisible, *it does not make any difference whether he did or did not perform or devote himself to the joint enterprise* [italics added; R. p. 90]. Witness Reeve testified he could not make the division counsel sought [R. p. 94]. Later in the record, trustee's counsel again sought to adduce evidence of the divisibility of the services [R. pp. 123-124]. He made a further explanation, seeking to show the importance of dividing the Hudson effort into percentages given for procurement, when the learned Referee, wholly mistaking the object of counsel's effort, and confusing the attempted division with a possible comparison of time spent by Reeve and Hudson, stated: "Now what difference does it make how much percentage of each man was devoted to procurement and how much to production? The Court does

not understand what you are getting at . . ." [R. p. 126]. Earlier, after trustee's counsel had rather fully and carefully explained the object and aim of his questioning, the learned Referee stated: "The Court is a little uncertain by what you mean by your explanation in view of the testimony of this witness that he and Mr. Hudson and others journeyed to Washington, stayed at the Statler Hotel there and used their joint endeavors to procure the contract" [R. p. 125]. Appellants respectfully urge that the learned Referee's own words establish his mistaken concept of the law when, after a clear statement by trustee's counsel of what he intended to prove by asking Mr. Reeve the question: "Mr. Reeve, in the services to be performed by Mr. Hudson as furnished to Lloyd R. Reeve, Inc., under this contract of April 7, 1954, to the best of your ability, can you estimate what portion of the services of Mr. Hudson were performed in procuring contracts and what percentage of the services were performed in the performance of the contracts after procurement?" [R. p. 124] the Referee inquired: "Now what are you trying to prove by your last question?" [R. p. 125].

Not perceiving the real issue of the cause as it occurred to and was presented by counsel for both parties, but emphasizing that the primary issue was that of the corporate *alter ego* he thought he saw in PPD Co., the learned Referee proceeded to a decision which made no division whatever of either the bankrupt's services or the compensation for them and awarded the entire compensation to the trustee, though only four days of time prior to adjudication had been spent in "procurement" and over one year after adjudication was spent in "performance" which made that compensation possible.

VII.

PPD Co. Was Not the Corporate Alter Ego of the Bankrupt.

In Finding of Fact VII the learned Referee holds that on April 3, 1954, when Articles of Incorporation of PPD Co. were filed in the office of the Secretary of State of California, it did not contemplate the transaction of any business save and except the joint venture deal between the bankrupt and Reeve, Inc., relating to the grain bin deal. Such is not a fair inference from the evidence and yet must have been of prime consideration in the Referee's finding of fraud.

As between inferences equally reasonable and equally susceptible of being drawn from proven facts, it is the duty of the trial court or jury to draw that inference which is favorable to fair dealing.

See:

Ryder v. Bamberger, 172 Cal. 791, 158 Pac. 753;

United States v. California Midway Oil Co., 259 Fed. 343.

Let us consider some of the proven facts from which the Referee had to draw the inference in Finding of Fact VII which we have above referred to.

The grain bin deal was discussed for the first time by Hudson and Reeve on April 3, 1954 [R. p. 71]. Negotiations had not ripened into a deal as late as April 5, 1954 [R. p. 75]. In such negotiations, Mr. Reeve had been told that Mr. Bloom was a part of PPD Co. [R. p. 71] but that there was a plan to take Mr. Bloom out of PPD Co. because of his interest in building at Palmdale. Mr. Bloom testified he was in dozens of meetings with

reference to the Palmdale building program [R. p. 273] and a corporate structure was desired in connection with it [R. p. 274] and Mr. Bloom was in favor of PPD Co as such corporation [R. p. 285]. His activity in affairs planned for the corporation had commenced as early as January, 1954 [R. p. 275] and continued until at least April 25, 1954. In the early references to a grain bin deal, at a time not definitely determined, Mr. Bloom was interested to get into the grain bin deal [R. p. 291], but what form of organization might finally define his interests was not clear to him because of the "fluid" nature of developments which somewhat depended on the attitude of Mr. Thornburg who owned the land and might finance the deal at Palmdale [R. pp. 282, 283, 296]. As Mr Bloom enthused about the Palmdale deal, he lost interest in the grain bin deal and finally divorced himself from it [R. p. 291].

From these proven facts Mr. Bloom's interest must be accepted (a) as being so substantial as to preclude a finding that PPD Co. was originated as a corporate *alter ego* of the bankrupt and (b) as existing prior to the signing of the corporation's articles in March, 1954. In view of the period during which the independent Bloom interest existed, the Referee could not fairly infer that on April 3, 1954, PPD Co. contemplated no business but the grain bin deal as stated in Finding of Fact VII.

In this connection, appellants would discuss the fact that the joint venture agreement allowed the possible assignment of it to Mr. Hudson. From this the Referee must have inferred fraud [Finding of Fact XIX, R. p. 23]. Such provision, when understood, is entirely consistent with the innocence of the bankrupt and his attor

ney of any fraud. The grain bin deal developed with are rapidity. Within 3 or 4 days after the bankrupt and Mr. Reeve first talked of it, they were in Washington, D. C., preparing a bid to CCC, the joint venture agreement having been drawn and executed. Contributing to his speed of unfoldment, Mr. Granger met with Mr. Minton and drew the joint venture agreement on April , 1954, when Mr. Granger did not know positively that PPD Co. was a corporation. However, as he had cleared he corporate name with the State at an earlier date [R. p. 253, 254] and the articles were in conventional form e expected there would be no delay and that on that day PPD Co. existed as a corporation though he would not ave had a report on it as yet from Sacramento. Deiding, somewhat upon the spur of the moment, to use hat corporate charter on the grain bin deal, Mr. Granger as faced with the fact that Mr. Bloom *might* have no nterest in the grain bin deal, though all Mr. Bloom's rior activity on the Palmdale deal might develop into a ubstantial building program for PPD Co. in which Mr. loom *would* have a substantial interest. It seemed proper nat a provision should be put in the joint venture agreeent which would allow for the divorcement of the Bloom nterest in Palmdale construction from the grain bin deal which he might have no interest. Without knowing hat the future held as to time and terms of such dircement, Mr. Granger hastily provided the assignment ause as a vehicle for divorcement. It was never used Mr. Bloom withdrew to set up his interest in a Thornurg corporation [R. pp. 283, 296].

It is not sound to reason that when as late as April , 1954, Mr. Bloom decided to channel his interest in the lmdale deal otherwise than through PPD Co. and

withdrew from such corporation, thereupon PPD Co. became the *alter ego* of the bankrupt with the retroactive effect of having been conceived in fraud. Surely a corporate structure, fairly evolved, cannot be deemed fraudulent from the start merely because one man, for fair business reasons that evolved slowly, retired from such corporation.

Proof of actual fraud is necessary to establish a transfer to hinder, delay and defraud creditors.

See:

Faulkner v. Magri, 90 F. 2d 808, 810.

VIII.

Assuming PPD Co. To Be the Corporate Alter Ego of the Bankrupt, Yet the Trustee and Creditors Are Not Entitled to the Bankrupt's Earnings and No Fraud Was Intended or Committed or Inequitable Position Created.

The conduct of the bankrupt or his attorney was not that of a man who was about to commit or in the course of perpetrating a fraud. They willingly testified to all facts with reference to planning and organizing PPD Co. After filing the petition in bankruptcy, they so informed Mr. Reeve [R. p. 116]. Mr. Granger's advice to Mr. Hudson about getting a release from his creditors or a discharge in bankruptcy was perfectly natural and proper advice under the circumstances. Mr. Bloom fully understood that Mr. Granger had initiated both the Palmdale and grain bin deals for his own business gain [R. pp. 273, 274, 278, 294]. There was never any attempt to conceal the fact that Mr. Hudson was to receive a compensation for his services from PPD Co. Indeed, the record in this case shows about $100,000 total profit

rom the grain bin deal by the joint venture [R. p. 95].)ne-half of this profit, which would be less than $50,000 vas to be paid unto PPD Co. which, without any de- luctions for any salaries for its officers or other purpose, vas obliged to pay the full receipts up to $50,000 to ne bankrupt. Any real effort at fraud would have in- olved an effort to appropriate otherwise than expressly o the bankrupt the *first* substantial funds which might therwise have gone directly to the bankrupt. The profit p to the full amount of this $50,000 was as much subject o the demands of Hudson's creditors in the hands of 'PD Co. as it would have been in the hands of Reeve had Hudson dealt directly with Reeve and there were no 'PD Co. Even under the fanciful theory of corporate *lter ego,* the first $50,000 was at all times vulnerable o creditors' attack as fully as if it had been owing by Reeve to Hudson, so, again we have no damage to cred- ors in relation to the profit made and it is idle to look or fraud up to that point.

Again, that Mr. Hudson executed the joint venture greement at Washington, D. C., on behalf of the cor- oration is not a badge of fraud. Mr. Reeve wanted a oint venture contract before the CCC bid was filed, ecause he wanted the Hudson experience in bin build- ng available to him before he contracted for a job on hich Mr. Reeve himself was inexperienced. The con- act had been flown to Washington, D. C., before cor- orate papers had been returned from Sacramento to anta Monica, and before its agents had a chance to gn it. Hudson's only authority was to sign the agree- ent and return it to PPD Co. Such mechanics were asonable under the circumstances presented by the speed the deal. The substantial sum of $50,000 was avail-

able to Hudson creditors before PPD Co. was to get a thing for its own officers and owners. Surely this was fair dealing as far as those creditors are concerned. Prior to bankruptcy Mr. Hudson had made an assignment for the benefit of his creditors in which his creditors were so well informed that (a) not one saw fit to examine him on a $500,000 loss at the first meeting of his creditors [R. p. 347] and (b) not one filed any specification in opposition to his discharge.

It is respectfully urged that the bankrupt was free of fraud and also free to contract with reference to future personal earnings and because of these facts and a complete absence of any inequitable treatment of creditors the creditors and the trustee have no right to any compensation for the bankrupt's services incident to the grain bin deal.

Respectfully submitted,

MERRILL L. GRANGER,

Attorney for Appellants.